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BUYING FARMS WITH LAND-BANK LOANS.

A STUDY BASED ON THE EXPERIENCE OF 2,700 FARMERS WHO HAVE BORROWED MONEY THROUGH FEDERAL FARM LOAN BANKS.

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PURPOSE AND METHOD OF STUDY.

The increase of farm tenancy in the United States and the steady migration of farmers and farm laborers to the cities have called attention forcibly to the need for effective means of assisting men in acquiring farms.

Since the outbreak of the recent war there has been much agitation for Government initiative in the opening up of undeveloped land, with an accompanying tendency to ignore the importance of facilitating the acquisition of farm land in regions already developed. To become a farmer in undeveloped regions involves much risk and hardship, including adjustment to new methods of agricultural practice, and frequently separation from relatives and friends. In developed regions the continual retirement of farm owners from active

work is likely to result in a rapid increase of tenancy unless it is readily possible for landless farmers to buy the lands previously operated by these retiring owners. It is true this transition to ownership is partly effected through inheritance, marriage, or gift, but this is the case only to a limited extent. To a great extent farm ownership among the new generation of farmers must result from purchase.

When the Federal farm loan system was under consideration it was widely believed that it would be an important instrument in reducing the percentage of tenant farmers. Those best acquainted with its provisions realized, however, that, while the act would prove serviceable in this regard, the credit permissible under its somewhat

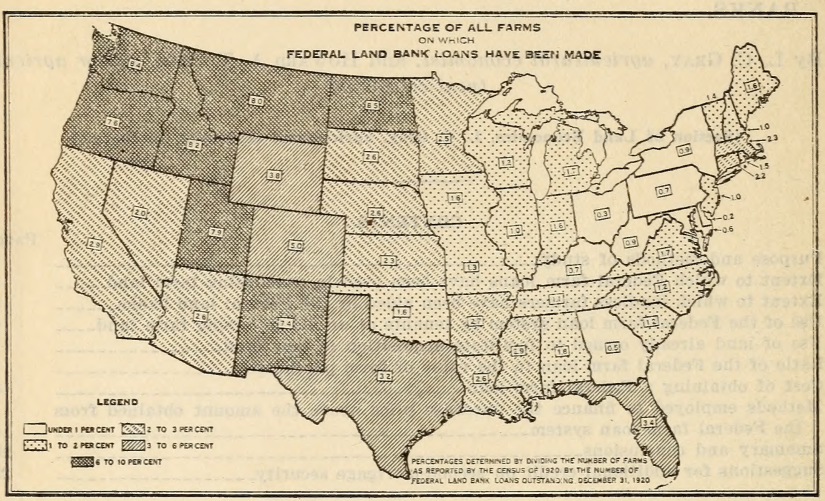

FIG. 1.

conservative provisions was made too small to effect a marked reduction in tenancy.

Since the Federal farm loan system has been in operation for about four years, it is important to determine the extent to which it facilitates the acquisition of farms by landless farmers, especially by those having little capital.

From this point of view the present study was undertaken to determine (1) what proportion of those borrowing under the Federal farm loan system for the purpose of buying land belong to the class just mentioned—that is, landless farmers with limited capital; (2) what methods such persons have employed to supplement the funds obtained from the Federal land banks; and (3) what have been the costs of Federal farm loans to the borrowers.

The point should be emphasized that the present study is not undertaken with the view of criticizing the farm loan system, its officials,

or its methods. Since the organization of the system notable progress has been made in extending its influence. Up to December 31, 1920, loans amounting to $369,242,464 had been granted by the 12 Federal land banks. Moreover, the ratio of the loans to the total number of farms appears to be high in those sections of the country where farm credit had been costly to the farmer. (See fig. 1.) In fact, it is probable that in parts of these regions the system has been an important influence in improving the terms of credit obtained by the farmers through private agencies.[1] In short, the fundamental purpose of the present study is merely to determine the extent to which the system provides for the needs of the landless farmer seeking to buy farm land.

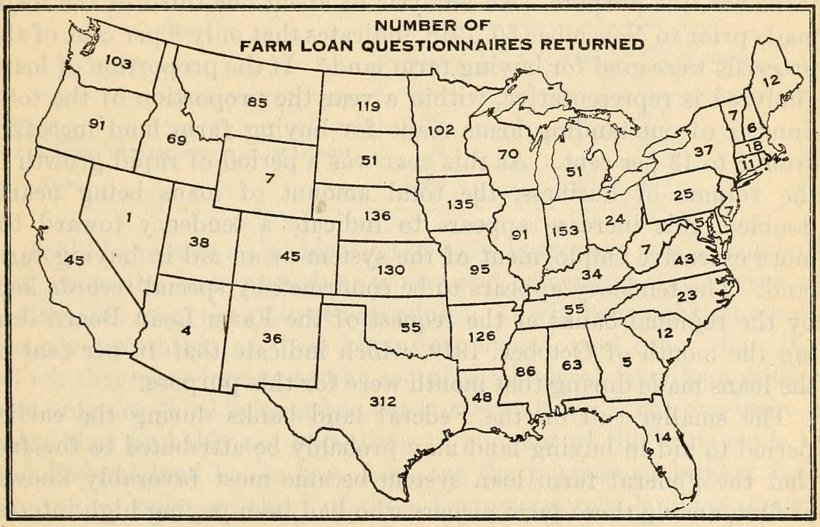

FIG. 2.—Distribution of some 2,700 replies received to questionnaire.

Some information on this point has been published by the Federal Farm Loan Board. These figures are presented in the following discussion. To supplement this information, 12,000 questionnaires were sent to persons who have borrowed under the Federal farm loan system, ostensibly for the purpose of buying farm land.[2] Approximately 2,700 replies were received, distributed as shown in the accompanying map (fig. 2). These replies constitute the principal basis of the discussion which follows.

The data are presented and interpreted on pages 5 to 20, following. The general conclusion derived from the data will be found on

[1] Second Annual Report, 65th Congress, 3d Session, House Document 1624, p. 5.

[2] The authors are indebted to the Federal Farm Loan Board for furnishing the addresses of these borrowers.

pages 20 to 23. Following these conclusions an attempt has been made to outline some constructive suggestions as to how the Federal farm loan system might be modified to render it more capable of facilitating farm ownership.

EXTENT TO WHICH FEDERAL FARM LOANS HAVE BEEN USED IN PURCHASING FARM LAND.

An analysis of 78 per cent of the total number of loans from the time of the organization of the Federal land banks to November 30, 1919, indicates that only 13 per cent of the amount thus loaned was for the purpose of purchasing farm land.[1] It is probable, however, that even this small percentage represents an increase in the proportion of loans for this purpose. An analysis of about one-third of the loans made prior to November 30, 1918, indicates that only 8 per cent of the proceeds were used for buying farm land.[2] If the proportion of loans analyzed is representative, within a year the proportion of the total number of outstanding loans made for buying farm land increased from 8 to 13 per cent. As this year was a period of rapid growth in the volume of business, the total amount of loans being nearly doubled, this increase appears to indicate a tendency toward the more extensive employment of the system as an aid in buying farm land. The tendency appears to be confirmed by special records kept by the regional banks at the request of the Farm Loan Board during the month of October, 1919, which indicate that 16 per cent of the loans made during that month were for this purpose.[3]

The smaller call on the Federal land banks during the earlier period to aid in buying land may probably be attributed to the fact that the Federal farm loan system became most favorably known, at first, among those farm owners who had been paying high interest and renewal charges on existing mortgages. Undoubtedly they were in large part men who organized most of the farm loan associations. Out of $251,426,600 of the loans made from date of organization to November, 1919, 59 per cent was borrowed to liquidate existing mortgages, and an additional 9 per cent for the payment of other debts of borrowers.

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1 Third Annual Report of the Federal Farm Loan Board, 66th Congress, 2d session, House Document 553, p. 11.

2 Second Annual Report, 65th Congress, 3d session, House Document 1624, p. 8.

3 A table which appears on page 58 of the hearings before the Senate Committee on Banking and Currency of the 66th Congress, 2d session, January 10, 12, and 13, 1920, indicates that a larger proportion of the loans made by the joint-stock land banks are made for the purpose of buying land than is the case with the Federal land bank loans. This table shows that of a total of $53,008,983 in loans made by 24 joint-stock land banks from organization to January 1, 1920, 26.5 per cent had been made to farmers buying their first land, 21.4 per cent to persons buying additional land, 8.3 per cent for the purpose of making improvements, and 43.8 per cent to pay existing indebtedness. In short, not far from half had been used to buy land.

EXTENT TO WHICH LANDLESS FARMERS HAVE BEEN AIDED BY THE FEDERAL LAND BANKS.

It will be clear also that by no means all of the loans made for buying farm land represent the borrowings of landless persons. A considerable number of such borrowings may be made by persons who already own farm land. Such persons may be operating the farm owned, or they may be renting it to others while they are themselves operating land as tenants.

TABLE I.—*Federal land bank borrowers buying land who answered the questionnaire, classified from the standpoint of ownership of other land and of tenure status as farm operators.*

Class.	Total in each group.		Owning other farm land.		Not owning other farm land.	
	Number.	Per cent of group.	Number.	Per cent of group.	Number.	Per cent of group.
Tenants	752	36.6	285	37.9	467	62.1
Not tenants	1,290	62.8	1,077	83.5	213	16.5
Not indicated whether tenants or not tenants	12	.6	6	50.0	6	50.0
Total	2,054	....	1,368	66.6	686	33.4

Table I presents a classification of 2,054 borrowers purchasing land for whom the facts regarding tenure and ownership status were ascertainable from the returned schedules. It will be noted that almost exactly two-thirds of these borrowers owned land other than that which they were buying by the aid of the Federal farm-loan system, and only one-third belonged to the landless class. When one bears in mind that probably not more than 15 per cent of the loans made by the Federal land banks have been for the purpose of buying farm land; that only one-third of these borrowers were landless, assuming the above answers to be representative; and, finally, that the total loans of the Federal land banks probably represent only about 8 per cent of the entire farm-mortgage indebtedness of the United States, it will be clear that the direct aid afforded by the system to the landless farmer in the acquisition of land has been relatively small. It should be noted, however, that it is a much larger proportion of the total new business. Moreover, not all landless farmers are persons who require unusually favorable credit facilities to aid them in buying farm land, for some landless farmers have wealth which may be used in buying land, and some landless persons who desire to buy farms are not farmers at all.

It is probable that the relative use made by landless farmers will increase as the possibilities of the Federal farm-loan system for financing the purchase of farms becomes better known among this class. The small proportion of the loans made to total mortgage in-

debtedness is largely owing to the newness of the system, and the rapid progress made in the past few years would seem to guarantee that its relative importance as a source of farm loans will be greatly increased in the future. It is also probable that the influence of the system has resulted in more favorable terms for loans made, and has thereby indirectly facilitated the acquisition of farms by landless farmers.

One might well expect that the proportion of loans made for the purpose of buying farm land would be smaller than the proportion made for the refunding of existing indebtedness for farm improvements and for other productive purposes. Because of the short period for which the average farm mortgage runs, as made by private agencies, the proportion of renewals to the total number of loans is large in any one year; and, except in "boom" periods, the rate of turnover in farm land is small.

Some light on the relative extent to which loans made by private agencies are used for various purposes is obtainable from previous studies made by the Department of Agriculture of rural credits. In 1913 it was shown that for the entire country loans were made for various purposes in the following proportions: To improve, 49 per cent; to purchase, 28 per cent; to refund, 23 per cent. Of all loans, 74 per cent were renewed.[1] Taken on this basis, the per cent of Federal land bank loans made for the purchase of land does not appear to have reached the proportion of private loans made for the same purpose.

It appears that the Federal farm loan system has demonstrated its possibility as an aid to the landless farmer in acquiring land. Further analysis of its use by borrowers indicates that it provides conditions considerably more convenient for the buyer who must finance a large part of the purchase price on credit than are afforded by the great majority of private agencies engaged in farm mortgage business. This, however, does not imply that the system could not be further modified so that it could be more readily employed in financing the purchase of farms by landless men of small capital.

USE OF THE FEDERAL FARM LOAN SYSTEM BY TENANTS AS AN AID IN BUYING FARM LAND.

As shown in Table I, 36.6 per cent of the Federal land bank borrowers reporting the purchase of land were tenants. No attempt was made in the inquiry to ascertain the status of the remaining borrowers, but various replies indicate considerable numbers of nonfarmers, both owning and not owning land, as well as of farmers operating as owners of all or part of their farms. Of the total number of ten-

[1] Testimony of Mr. C. W. Thompson before the subcommittee on Banking and Currency, House of Representatives, 63d Congress, 2d session, Dec. 3, 1913.

ants 37.9 per cent own other farm land, and 62.1 per cent are landless, while in the case of nontenants the per cent owning other farm land is much higher, amounting to 83.5 per cent. Of the total number of borrowers giving the facts regarding their previous tenure and the amount of land which they owned, 23 per cent consisted of landless tenants.

USE OF LAND ALREADY OWNED TO FACILITATE ACQUISITION OF NEW LAND.

While it was not always possible from the information obtained to determine the extent to which land already owned was used in buying other land, it seems clear that, in large part, the land already owned was employed in one way or another for this purpose. Out of 700 cases of borrowings made by farmers already owning land, 500, or over 70 per cent, seem to have borrowed on the security of land already owned as well as the land being purchased, for in this proportion of cases the amount of the mortgage was 50 per cent or more of the value of the farm purchased. In addition to the cases in which the inference is fairly certain, it is probable that of those who borrowed less than 50 per cent of the value of the new farm in order to make the purchase a considerable number had used the land already owned, either by selling it or by mortgaging it.

RATIO OF THE FEDERAL FARM LOAN TO THE VALUE OF THE FARM PURCHASED.

Table II gives, in the case of 1,168 loans, the average percentage of the value of the land bought which the first mortgage represented. It was necessary to omit from the table some of those owning other land, because of the possibility that the mortgage indebtedness might rest not only on the farm newly purchased but also on the additional land owned. That this was frequently true is indicated by the considerable number of cases in which the mortgage was more than 50 per cent of the value of the new land purchased.

TABLE II.—*Relative size of Federal farm loan obtained for different tenure groups.*

Tenure group.	Number of farms.	Average per cent Federal farm loan is of the cost of the farm purchased.	Average cost of farm purchased.	Average size of the Federal land bank mortgage.
Non-owning buyers	558	44.2	$8,072	$3,566
Owner-buyers, including tenant owners	610	41.5	9,652	4,007
Total	1,168			
Non-owning tenants	406	44.1	8,224	3,632
Owning tenants	133	42.4	9,620	4,077

It seems clear that, in general, persons borrowing to buy land have borrowed a larger proportion of the value of the land mortgaged than the average for all borrowers, which was found to be 37 per cent for $251,426,600 out of the total $282,007,781 outstanding Federal land bank loans November 30, 1919.[1] For owner-buyers the loan is 41.5 per cent of the value, while non-owning buyers appear to have found it necessary to borrow nearer the limit allowed by the Federal farm loan system, their loans averaging 44.2 per cent.

The figure 44.2 per cent is very close to the limit allowed by law for, although the loan may be 50 per cent of the value of the land, only 20 per cent is allowed on the value of permanent insurable improvements, so that the average percentage must be considerably less than 50 per cent of the value of the farm. In fact, on the basis of the ratio of the value of land to the value of buildings for the entire United States, as shown by the 1910 census, the average maximum that could be loaned under the law would be 44.5 per cent of the value of land and buildings combined. Thus, it is obvious that those borrowing for the purpose of purchasing land have approximated the maximum that may be borrowed under the law.

COST OF OBTAINING A FEDERAL FARM LOAN.

Objection is sometimes raised to the use of Federal farm loans on the ground of their initial cost. If it is expensive to obtain these loans the purchaser of land may not be willing or able to stand the added expense at the start over what it might cost him to obtain a temporary loan from some other source. Lack of comparable information makes it difficult to compare the cost of obtaining loans from the Federal land banks with the cost of obtaining farm loans from other sources. Answers to questions designed to elicit information on the cost of Federal farm loans were received from 1,765 borrowers, and these answers make it possible to present information on the average cost of these loans. This average cost amounted to $50.84, or 1.43 per cent of the mortgage given to the Federal land bank, which averaged $3,541.

Borrowers of small amounts find the loans from the Federal land banks relatively more expensive than larger borrowers do, and this makes it more difficult for the buyers of inexpensive or smaller tracts of farm land to finance their purchases. There were 347 borrowers reporting the cost of borrowing who gave mortgages to the Federal land banks for $1,000 or less, and the loans cost these borrowers an average of $36.01, or 4.82 per cent of the mortgage given. On the other hand, while the cost of borrowing averaged

[1] Third Annual Report of the Federal Farm Loan Board, 66th Congress, 2d session, House Document 553, p. 12.

$82.74 for the 187 borrowers who gave mortgages to the Federal land banks for amounts between $7,501 and $10,000, this cost represented only 0.9 per cent of the mortgage given.

The borrower planning to finance the purchase of a farm through the aid of a loan from a Federal land bank has not only to anticipate the costs connected with getting the desired loan, but he must allow for the amount withheld as his pro rata share of bank stock, or 5 per cent of the total amount of the mortgage given. In other words, the 1,765 borrowers realized an average of $93.57 for every $100 of mortgage given to the Federal land banks; borrowers giving mortgages for $1,000 or less realized approximately $90 on every $100 of mortgage given; and borrowers giving mortgages for amounts running between $7,501 and $10,000 realized approximately $94.00 on every $100 of mortgage given.

Tables III and IV give in some detail information on the cost of loans from Federal land banks, based on answers by 1,765 borrowers. (See also fig. 3.)

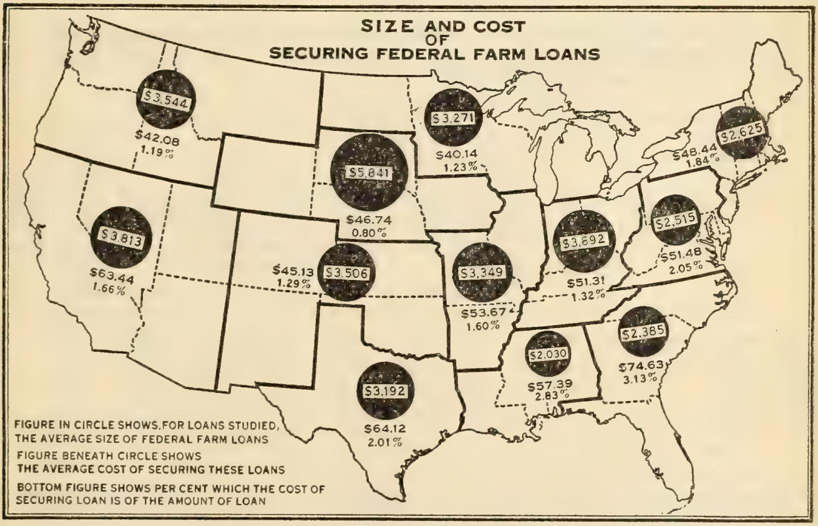

FIG. 3.—Size and cost of Federal farm loans, by land-bank districts.

TABLE III.—*Costs incurred in obtaining Federal farm loans. (Analysis and averages of 1,765 reports.*[1]*)*

Size of average loan	$3, 541. 00
Average cost of securing the Federal farm loan	50. 84
Per cent which the average cost of securing the loan is to the loan	1. 43

[1] Of the 1,765 borrowers reporting the cost of borrowing by items, 75.8 per cent reported expense for abstracting. It is probable that part of the expense reported under lawyer fees is also on account of abstract work done, especially in the First Land Bank District, comprising the New England States, New York, and New Jersey, where as many reported expense for lawyer fees as reported abstract expense and where the amount reported as lawyer fees exceeded that reported as abstract expense. Expenses itemized under the expression "application," "application fee," "association fee," "secretary fee," and "land bank fee" are probably not strictly correct in many instances, but if the total amount paid on all of these items is used that total amount may be considered as being fairly correct. In other words, it is thought probable that many borrowers did not correctly discriminate in entering amounts paid out to or retained by the land banks or association, although their total expense for such items is probably correct.

Elements of cost.	Per cent of all records reporting each item of cost.	Per cent of average cost represented.	
Application	18.9	3.31	
Application fee	33.2	6.58	
Association and secretary fees	50.9	16.95	
Land bank fee	34.7	9.71	
Appraisal and costs connected with appraisal	34.9	7.35	
Title determination by Federal land banks	18.4	3.75	
All land bank and national farm loan association charges			47.65
Abstract of title	75.8	27.41	
Extra abstracting	13.1	3.37	
Title insurance	9.9	2.49	
Surveying	6.1	1.58	
Affidavits	12.2	.56	
Legal papers and fees for filling them out	12.0	1.35	
Lawyer fees	13.0	4.92	
Notary fees	29.4	1.07	
Recording fees and recording taxes	57.1	4.15	
Internal-revenue tax stamps	39.1	1.92	
Title charges, i. e., itemized charges other than those made by the land banks and national farm loan associations			48.82
Nonitemized charges			3.53
All charges			100.00

TABLE IV.—*Relation of the land bank and National Farm Loan Association charges and the costs in connection with the title to the amount secured on Federal farm loans of different sizes.*

Size of loan.	Number of mortgages averaged.	Size of average mortgage.	Total cost of mortgage.	Per cent cost of loan is of amount of loan.	Total land bank and association charges.	Title costs.	Per cent land bank and association charges are of mortgage.	Per cent title costs are of mortgage.
$1 to $1,000	347	$747	$36.01	4.82	$10.90	$22.38	1.46	3.00
1,001 to 2,500	530	1,815	41.28	2.27	16.37	23.63	.90	1.30
2,501 to 5,000	483	3,705	50.43	1.36	24.39	23.86	.66	.64
5,001 to 7,500	205	6,392	68.09	1.07	35.55	29.60	.56	.46
7,501 to 10,000	187	9,186	82.74	.90	52.01	27.32	.57	.30
10,001 and over[1]	13	16,231	120.23	.74	90.04	27.91	.45	.17
All cases	1,765	3,541	50.84	1.44	24.21	24.64	.68	.70

[1] While $10,000 is by law the maximum which may be borrowed by one person from Federal land banks, larger loans are evidently secured on what some borrowers consider to be one farm. This might be the result if two or more persons owned distinct parts of what may be operated as a single farm, each owner obtaining a loan on his part of the farm from the Federal land bank.

The prospective purchaser of land who plans to buy with money, part of which he borrows from a Federal land bank, should give due consideration to the possibility of delay in the completion of negotiations for a loan. Cases have occurred in which prospective buyers have made deposits on land to secure a contract of sale, which contract they have forfeited because they were unable to complete the purchase, money which they depended upon Federal land banks to furnish being held up for one reason or another. Frequently, delay is due to failure to comply with the requirements of the Federal land

banks regarding the title to property; but the possibility of delay for other reasons, such as the impracticability of the appraiser for the land bank promptly viewing the land, should be foreseen, and the contract of sale should be made to cover a sufficient time.

METHODS EMPLOYED TO FINANCE THE PURCHASE PRICE ABOVE THE AMOUNT OBTAINED FROM THE FEDERAL FARM LOAN SYSTEM.

A question of special interest in the present study is, How did those who borrowed from the Federal land banks for the purpose of buying farm land finance the remainder of the purchase price above the amount obtained by first mortgage? Or, more particularly, To what extent were second mortgages employed for this purpose, and what were the terms of these second mortgages?

EXTENT OF USE OF SECOND MORTGAGES.

To answer these questions it is possible to use 1,008 replies in which a complete record of the conditions of purchase were given. Of this number, 477 did not involve second mortgages, while 531 did. Of the latter number, second mortgages were given to relatives who were also sellers of the land in 43 cases, and to other sellers in 372 cases. Thus in practically 78 per cent of the cases the second mortgage was given to the sellers of the land—that is, to persons who might presumably be interested in giving specially favorable terms. In only 22 per cent of the cases were the mortgages given to others than sellers of the land.

The terms of purchase for these 1,008 cases are summarized in Table V.

TABLE V.—*Use of the second mortgage by borrowers from the Federal land banks in order to complete the purchase.*

Class of case.	Number of records.	Averages.						
		Cost of farm.	Cash or trade.[1]	Second mortgage.	Interest rate on second mortgage.	Per cent in—		
						Federal loan.	Second mortgage.	Cash or trade.[1]
No second mortgage given	477	$8,294	$4,912	....	....	41.0	....	59.5
Second mortgage given	531	9,874	2,414	$3,363	6.7	43.3	34.1	24.4
Second mortgage held by:								
A relative who is the seller	43	12,807	2,209	5,087	5.8	43.9	39.7	17.3
Other sellers	372	9,162	1,983	3,424	6.6	43.3	37.4	21.6
Parties other than sellers	116	11,069	3,873	2,527	7.2	43.1	22.8	35.0
All cases	1,008	9,126	....	....	....	42.7	....	....

[1] This item includes some of the expenses incident to borrowing.

As one would expect, those finding it necessary to borrow on second-mortgage security obtained a larger average per cent of the purchase price on first mortgage than did those who did not employ second mortgages.

The 477 buyers giving no second mortgage gave first mortgages to the Federal land banks that averaged 41 per cent of the cost of the farms purchased. The remainder of the purchase price was paid in cash or by trading other property. The 531 buyers giving a second mortgage additional to the first held by the Federal land banks, which averaged 43.3 per cent of the cost of farms purchased, obtained 34.1 per cent of the cost of the farm on the second mortgage. The amount put in by this group in cash or trade averaged 24.4 per cent of the cost of the farm.

INFLUENCE OF PERSONAL RELATIONSHIPS ON THE TERMS OF SECOND MORTGAGES.

The better terms on which farms are bought by men who are able to get relatives to accept second mortgages, whether buying from such relatives or from others, are reflected by the averages for the group of 43 buyers who bought, giving second mortgages to their relatives. The second mortgage held by relatives of the buyer averaged 39.7 per cent of the cost of the farm and bore interest at the average rate of only 5.8 per cent per annum, little more than the total annual cost of the first mortgage. The amount put in by this group in cash or trade amounted to only 17.3 per cent of the cost of the average farm. These men bought farms averaging $12,807 in value, this amount averaging higher than the farms in any other group. That the price paid was reasonable in most cases is indicated by the fact that 43.9 per cent of the purchase price was accepted as mortgage by the Federal land banks.

When sellers of land, even when not related to the buyers, accept a second mortgage in part payment, they are frequently willing to give favorable terms of credit because they are anxious to effect a sale. This tendency is reflected in the terms of second mortgages given to former owners (Tables V and VI). It appears that in this group the second mortgages averaged 37.4 per cent of the purchase prices of the farms. This is slightly less than the percentage for mortgages given to relatives who were sellers, but much higher than the proportion of the purchase price (22.8 per cent) represented by mortgages given to persons who were not sellers. The tendency toward favorable terms in mortgages held by sellers of farm land who are not related to the buyers is shown by the average interest rate of 6.6 per cent, as compared with an average of 7.2 per cent on mortgages held by persons other than sellers.

It is probable that the terms on mortgages given to the class of persons other than sellers represent fairly closely the typical conditions for ordinary commercial loans on second mortgages. However, some of these loans may have been given to relatives or other persons who had some special motives for granting specially favorable terms.

The need of popularizing the second mortgage when given in connection with the purchase of a farm through the aid of a first-mortgage loan obtained from the Federal land banks is strongly suggested by the fact that, of the entire number of farms purchased on which second-mortgage loans were obtained, only 116, or 22 per cent of the entire 531, were taken by men who were reported neither as relatives of the purchaser nor as the former owners of the land. If second mortgages given in connection with Federal farm loans were looked upon with more favor by men having money to lend, there would doubtless be a wider use of the Federal land bank mortgage as a means of acquiring land by persons having a small amount of money, but not enough to operate a farm and pay for the full amount of its cost not covered by a loan which they could get from a Federal land bank.

PROPORTION OF PURCHASE PRICE OBTAINED ON SECOND MORTGAGE.

In Table VI is shown the percentage of the purchase price represented by second mortgages in the case of 527 farms purchased through the aid of second mortgages, for which complete data are available. Of these, 167, or 32 per cent of the second mortgages, were for one-fourth or less of the purchase price, and 18 per cent for more than half of the purchase price. Men who purchased from sellers who were not their relatives, but who were willing to accept the second mortgage in lieu of part of the cost of the farm, placed more than half of the cost of the farm on second mortgage in 22 per cent of the cases. Of the men who were able to get relatives to accept the second mortgage, 10 out of a total of 32, or 31 per cent, were accommodated with second mortgages which represented more than half of the purchase price of the farm. On the other hand, only 4 of the 107 second mortgages which were held neither by the former owner of the land nor by a relative of the buyer of the farm were for more than half the cost of the farm.

TABLE VI.—*Purchasers classified according to promotion of price raised on second mortgage and relationship to former owners.*

[Giving of mortgages coincident to the purchase of farms, and first mortgages held by Federal land banks.]

Per cent second mortgage is to total cost of the farm.	Number of records.	Per cent of all records.	Holders of second mortgage— Former owners. Related to the purchaser. (32 records).	Holders of second mortgage— Former owners. Not related to the purchaser (388 records).	Holders of second mortgage— Not former owners. (107 records).
			Per cent.	*Per cent.*	*Per cent.*
1 to 25	167	32	10	26	60
26 to 40	157	30	34	30	27
41 to 50	105	20	25	22	9
Over 50	98	18	31	22	4

PERIOD OF REPAYMENT OF SECOND MORTGAGES.

By placing as large an amount of the cost of the farm as possible on first and second mortgages, the purchaser who is short on cash husbands his resources so that he may have enough on which to operate his farm. But the conditions of repayment on his mortgages should be such that he will not be embarrassed in meeting the payments.

On the first mortgage given to the Federal land bank he must pay 6½ per cent each year (if the mortgage was given on or after December 7, 1917), this amount sufficing to pay the interest due each year and to reduce the principal so that in 34½ years both principal and interest will have been fully paid. The payments on the Federal land bank loan are made annually or semiannually, and the comparatively small payments to be made at any one time should not embarrass the borrower.

Table VII shows the time by which the second mortgages were found to be fully payable as shown by 576 second mortgages made in connection with the purchase of farms on which loans on first mortgages were obtained from Federal land banks. Two out of every 10 of these second mortgages were payable in full by the end of the second year and seven out of every 10 by the end of the fifth year. A larger number of second mortgages were payable in full by the end of the fifth year than by the end of any other period, 29 per cent having the fifth year specified as the date of final payment. Only one out of every 20 was not fully payable by the end of the tenth year. A larger proportion of the buyers who borrowed on second mortgages from relatives were allowed longer than two years than in the case of those who borrowed from others than relatives, and a larger pro-

portion who borrowed on second mortgages held by the former owner were allowed longer than two years than was the case with those who borrowed from men who were not the men from whom they purchased.

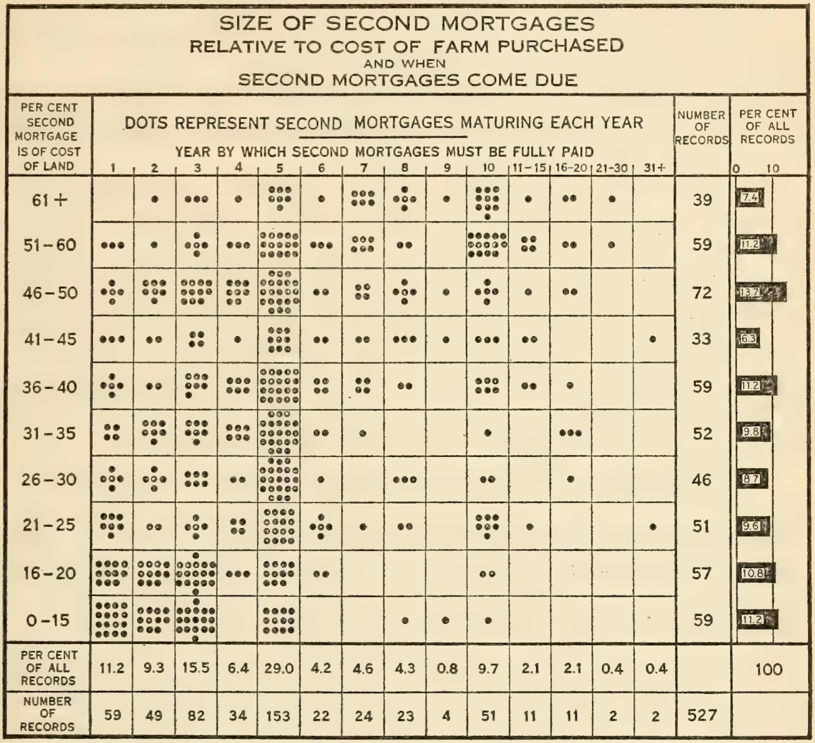

FIG. 4.—Analysis of terms of 527 second mortgages given in connection with purchase of farms for which the first mortgages were held by Federal land banks.

TABLE VII.—*Time by which second mortgages are fully payable.*

[First mortgage held by Federal land banks, and giving of mortgages coincident to the purchase of the land.]

Holder of second mortgage.	Number of records.	Per cent fully payable— By end of second year.	After second but by end of fifth year.	After fifth but by end of tenth year.	After tenth year.	Special (usually no fixed maturity).
Relative who is former owner	36	5.8	41.7	36.1	5.5	11.1
Other former owners	395	17.0	48.4	27.6	6.6	.3
Other than former owners	145	33.1	53.8	8.3	2.1	2.8
All cases	576	20.3	49.3	23.3	5.4	1.7

It also appears that, in general, the period of repayment tends to be longer in the case of second mortgages which represent a comparatively large proportion of the purchase price. For 527 records of second mortgages made in connection with the purchase of farms and with the giving of a first mortgage to the Federal land banks, it was possible to determine the relationship between the period of repayment and the size of the second mortgage. Figure 4 shows in detail how many of all these mortgages were fully payable by the end of various terms, the records being grouped according to the relative size of the second mortgage.

Approximately three-fifths of those second mortgages which amounted to over half of the cost of the purchased farm were not fully payable until after the fifth year, and approximately one-fourth of those amounting to between two-fifths and half of the cost of the purchased farm were not fully payable until after the fifth year. On the other hand, approximately three-fourths of the second mortgages amounting to one-fifth or less of the purchase price were fully payable by the end of the fourth year, and over nine-tenths of them were fully payable by the end of the fifth year.

PROVISIONS FOR PERIODIC REPAYMENT OF SECOND MORTGAGES.

As in the case of Federal farm loans, provision for periodic repayment of the second mortgage loan is likely to be an important aid to the landless man possessing little capital. Table VIII shows the percentages of second mortgages repayable in various ways. Half of the second mortgages are payable at the end of the mortgage period without any provision for periodic payments to reduce the amount of the principal aside from instances where it was understood that the borrower had the privilege of paying off the second mortgage as he chose, usually at the interest paying date and in multiples of 50 or 100 dollars. Mortgages coming due as a lump sum at the end of the mortgage period occur with especial frequency in the group of 144 buyers who did not borrow on second mortgages from the man from whom they purchased the land; seven of every ten of these men have mortgages repayable in that manner. About two out of five borrowers were under obligation to make annual payments on their second mortgages. Borrowers who were indebted on second mortgage security to relatives were particularly favored as to the final payment of their second mortgages, a third of these borrowers being permitted to make full payment practically at their own option. Few cases of second mortgages repayable in monthly or semiannual payments were found.

TABLE VIII.—*Manner of repaying amount loaned on second mortgage.*

[First mortgage held by Federal land banks and giving of mortgages coincident to the purchase of the land.]

Holder of second mortgage.	All cases.	Per cent of second mortgages repayable—					
		Monthly.	Semiannually.	Annually.	End of mortgage period.	Any time optional.	Other ways.
Relative who is former owner	35		2.9	17.1	40.0	34.3	5.7
Other former owners	398	1.0	0.3	46.7	44.5	1.5	6.0
Other than former owners	144		0.8	20.1	70.1	7.6	1.4
All cases:							
Per cent		0.7	0.5	38.3	50.6	5.0	4.9
Number	577	4	3	221	292	29	28

In Table IX second mortgages involving the privilege of periodic repayment are grouped according to the size of annual payments. There were 240 second mortgages repayable in periodic payments on which it was possible to determine the relation of the size of the periodic payments to the cost of the farm. Ignoring interest, it is found that about one-third of these 240 borrowers are under obligation to pay to the holder of the second mortgage, each year till the second mortgage is fully paid, an amount up to 6 per cent of the original cost of the farm by way of reducing the amount of the second mortgage. Payments larger than this, on second mortgages of any considerable size, would be rather hard to meet out of the income of the farm in addition to the payment of interest on the second mortgage, and interest and amortization on the Federal land-bank loan. Yet the greater number of the rest of these second mortgages are so arranged that there is annually due on the repayment of the second mortgage an amount exceeding 6 per cent of the cost of the farm in addition to the interest due on the second mortgage.

TABLE IX.—*Periodic repayment of second mortgages; size of annual payments.*

[Per cent of total cost of farm, ignoring interest.]

Annual payment.	Number of records.	Per cent of all records.	Annual payment.	Number of records.	Per cent of all records.
Up to 4 per cent	33	13.8	Over 15 per cent	15	6.2
4 to 6	45	18.8	Special cases	37	15.4
6 to 8	37	15.4			
8 to 10	36	15.0	Total	240	100.0
10 to 15	37	15.4			

In at least one instance the Federal farm-loan plan of repaying the interest and amortizing the principal has been copied by the seller of his farm in drawing up the terms of repayment on the second mortgage, which he accepted in part payment for his farm. In buy-

ing a Missouri farm at a cost of $15,500 a man who up to that time had been a tenant put into the purchase $2,500 of his own money. As to the balance of the purchase price he borrowed $6,500 from the Federal land bank, and the man from whom he purchased took a second mortgage equal in amount to that taken by the Federal land bank and on the same terms, both as to interest and as to the size of the semiannual payment. These terms make it possible for this former tenant to own the farm clear of all encumbrances in 34½ years from the time he purchased by making semiannual payments of $422.25 until the end of that time, this amount so paid being sufficient to pay the interest and amortize the principal of both the first and the second mortgages.

Several purchasers reported that the man from whom they bought accepted a second mortgage, payable in full by the end of 20 years, interest on any unpaid balance being paid annually, and in addition an amount equal to a twentieth of the face of the loan, so as to pay off the second mortgage in full by the end of the twentieth year.

In another case the seller of a farm permitted the buyer to place a Federal land-bank loan on the farm, and accepted a second mortgage in part payment, due in 20 years, with provision for payments at the option of the purchaser up to the end of the twentieth year. In such a case the holder of the second mortgage has the assurance that his second mortgage is becoming more secure each year, because his mortgage is second to a mortgage that is being reduced in amount every six months by a payment on the principal.

The principle of deferring the first annual payment for more than one year after the negotiation of the loan is observed in a few of the second mortgages subject to periodic repayment. In two cases payments begin to come due on the second mortgages not until the fifth year, in seven cases in the third year, in five cases in the second year. However, most of the mortgages—228 in all—provide for the first payment by the end of the first year after the date of the second mortgage. Arrangements for deferred payment such as those just described are likely to prove of considerable advantage in the case of a purchaser who needs all his available cash during the first few years to place the farm on a paying basis.

RATES OF INTEREST ON SECOND MORTGAGES.

The interest rates on second mortgages were found to average 6.8 per cent. The rate for the various Federal land-bank districts is shown in figure 5. While the average rate is highest for the Texas land-bank district, which comprises the single State of Texas, it is considerably higher for several other individual States, for instance, Arizona, 10 per cent; New Mexico, 8 per cent; Arkansas, 8 per cent.

It is a striking fact that the average rate of interest on second mortgages is about the same as the average on first mortgages made by private lenders, as obtained by an earlier investigation made by the department. In fact, the average rate on first mortgages, 6.9 per cent, is slightly higher than the average for second mortgages. A comparison of average rates by Federal land-bank districts shows also a considerable degree of correspondence. (See figs. 5 and 6.[1]) While the averages for the two classes of mortgages are only roughly comparable, the correspondence in the two rates is sufficiently close to suggest that probably rates on second mortgages do not tend to average much higher than those on first mortgages.

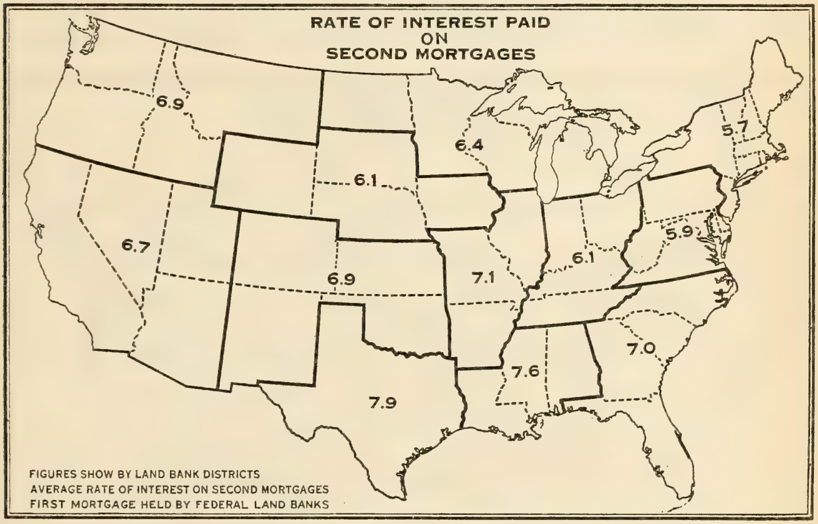

FIG. 5.—Average rate of interest paid on second mortgages, by Federal land-bank districts.

The tendency for average rates of interest on second mortgages to approximate closely the first-mortgage rates has been confirmed also by a recent survey of land sales in Iowa, where the average rates on second mortgages proved to be 5.7 as compared with 5.3 for first mortgages.[2]

At least two important conditions may be considered responsible for the tendency. In the first place, a large proportion of second mortgages are given to sellers of land who for one reason or another are willing to give better credit terms than would be allowed if the

[1] The data on first mortgages are based on reports for 47 States, the results of which are published in Department Bulletin 384. This bulletin gives no average for the entire United States. The average employed above, therefore, is an average by States. Moreover, the data were obtained in 1913. For these reasons the averages are only roughly comparable.

[2] Farm Loan Values in Iowa, by L. C. Gray and O. G. Lloyd, Bulletin 874, U. S. Dept. of Agriculture, p. 17.

loan were made on considerations of credit alone. In the second place, it is probable that legal restrictions on interest rates exert an important influence on normal interest rates for second mortgages, as well as in the case of first mortgages. In various ways additional charges probably are employed to supplement the normal interest rate. In general, this seems to be another indication of the fact that lending on second mortgages has not been widely developed on a commercial basis.

SUMMARY AND CONCLUSIONS.

The Federal farm-loan system has been employed to a considerable and an increasing extent to enable men to buy land. The proportion of loans for this purpose has probably not yet reached a maximum.

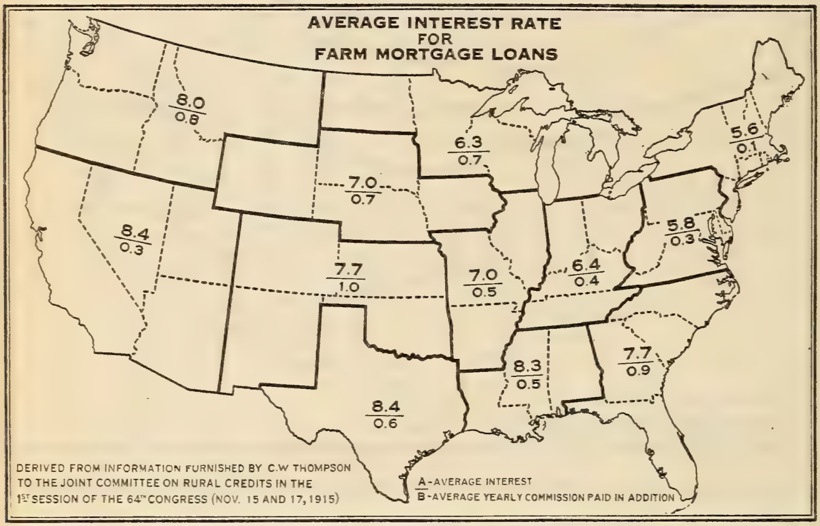

FIG. 6.—Average interest rates for farm mortgage lonas, by Federal land-bank districts.

In addition to the loans made directly for this purpose, it is probable that loans made for refunding indebtedness and for other purposes improve the financial position of the farmer to such an extent as to enable him to invest in additional land.

To a large extent the use of the system for acquiring farm land has been by those already owning farm land, about two-thirds of those who borrowed to buy land belonging to this class. Of the landless borrowers, about two-thirds were operating as tenants at the time of borrowing.

While it is apparent, therefore, that landless persons desiring aid in acquiring the ownership of farm land have not resorted extensively to the farm land banks, an examination of the methods employed by

this class to finance their purchases indicates that the Federal land banks provide more favorable conditions for the purchase of farms by those having but a small proportion of the purchase price than prevailed before the development of the Federal land bank system. This is true because the system makes it more practicable to lend on second mortgages than under the arrangements for farm-mortgage credit usually provided by private enterprise.

Prior to the development of the Federal farm loan system men who had money to lend were slow to put it out on second-mortgage security, and, broadly speaking, lending on second mortgage has never been well organized or extensively employed. As shown by this and other studies, a large majority of such loans are made by persons who are selling the land mortgaged and are willing to grant unusually favorable terms to effect a sale, or by relatives or others who are inclined on personal grounds to lend under easier conditions than are afforded by regular credit agencies. Probably a large proportion of the remainder of second-mortgage loans are handled by local individual money lenders or by country banks. Comparatively a small percentage of such loans are made by large organizations operating over a wide territory.

In part, this failure to develop second-mortgage credit on a commercial basis has been due to the prevailing system of first-mortgage credit as afforded by private agencies. With the short-time first-mortgage loan there is always considerable danger that foreclosure may take place, with resulting extinction of the equity of the holder of the second mortgage. Even were this danger not present, the necessity of repaying the first mortgage within so short a period greatly limits the borrower in safely assuming a margin of indebtedness above the first mortgage to be repaid in an equally short period. This limitation is increased in many sections by high rates of interest and commission and by conditions of renewal.

Most men who have money to lend do not care to put it out on second-mortgage security under ordinary conditions. Doubtless they are well justified in this conservatism when the second mortgage is preceded by a first mortgage that represents a large part of the sale value of the property, when that first mortgage bears so high a rate of interest or is repayable in such a way as to make it quite possible that the holder of the first mortgage may have to foreclose in order to make the borrower live up to its terms, or when the title to the farm is questionable. But the position of the holder of a second mortgage is far more secure when his mortgage is second only to a mortgage held by a bank of the Federal farm loan system. These banks are very careful in placing their loans, which are almost certain to be for less than half of the value of the farm, inasmuch as

they appraise conservatively, refuse to expand their loans because of boom conditions, lend only up to half of the appraised value of the land and one-fifth of the appraised value of the buildings, and are especially cautious in lending on such security as orchards and woodland. In fact, as shown above, the average ratio of the loan to the value of the land for all classes of buyers is only 37 per cent, while for landless persons borrowing to buy land it is only 44.2. Moreover, the Federal land banks refuse loans on the security of land for which good title can not be given. The lender on second mortgage may enjoy the benefit of this careful examination without extra expense either to himself or to the borrower. Year by year, as the borrower pays the amount required of him for interest and amortization, the position of a person holding a second lien becomes more secure, and there is no large final payment to be made on the first mortgage that is likely to result in foreclosure proceedings or to embarrass the borrower in meeting his obligations under the second mortgage. The interest rate on Federal land bank mortgages is low and the amount due as interest and payment on the principal is not large in proportion to the total value of the farm.

It is obvious that these conditions provide a far more favorable basis for second-mortgage loans than was provided by the usual types of first-mortgage loans on farm lands. It is not strange that numerous borrowers and lenders have taken advantage of this favorable opportunity to negotiate second-mortgage loans, and it is to be expected that regular private credit agencies may avail themselves to some extent of this opportunity.

It is doubtful, however, whether we can rely on private enterprise to develop extensive facilities for loans secured by second mortgages on farm property. Unless some special motive exists for making such a loan, such as desire to sell the land, it is not an attractive investment except at such a high rate of interest that it is likely to prove a millstone around the neck of the borrower. It is difficult to resell such mortgages in the general market unless indorsed by a large and well-known credit agency. Consequently they can not readily be made the basis of a profitable loan business in which the lender employs his capital in making loans to be disposed of to investors, making his profit out of a relatively small margin multiplied by the rate of turnover. In the case of first mortgages, trust companies and mortgage loan companies can make considerable profit by continually turning over their capital in this manner. It would appear, therefore, that if adequate credit arrangements for *bona fide* farmers who are attempting to buy farms with a small initial margin of capital are to be provided, it will be necessary to rely largely on the Government to make such provision.

Such arrangements are justified on the grounds of public policy. Home ownership is a basic element in the economic and social stability of the Nation. A large percentage of farm tenancy is unfavorable to an efficient and permanently productive agriculture and a wholesome and stable community life. Some tenancy is necessary, and probably even desirable. It is the part of good policy to accept this fact and to devote our energies to reducing the incidental evils; but it is also the part of good policy to prevent the proportion of tenants from becoming abnormal. So long as young farmers may as a rule hope to become owners of land after a series of years as tenants, tenancy is not fraught with the social evils which come with the establishment of a permanent tenant class; hence the importance of keeping the road open to the top.

One of the more important causes of the tendency in the direction of providing credit for farmers is the fact that the estimated average value of farm land and improvements in the United States appears to be between three and four times as great in 1920 as it was in 1900. This represents an increase of approximately $20 per acre from 1900 to 1910 and $31 per acre from 1910 to 1920.[1]

In many parts of the country the value of a farm now represents a considerable fortune. Therefore it may be doubted whether in certain sections the average man can hope to accumulate such a fortune out of the profits of farming even in a lifetime. It is certainly exceedingly difficult in many sections of the country for a man starting with little or no property to accumulate in a reasonable length of time all that part of the purchase price of a farm in excess of the proportion usually lent on first-mortgage security. It would seem clear, therefore, that more liberal arrangements for farm-mortgage credit must be provided as an important phase in the development of a constructive policy with reference to farm land.

SUGGESTIONS FOR ADDITIONAL CREDIT ON SECOND-MORTGAGE SECURITY.

Although the purpose of the present study is to ascertain certain facts with regard to the employment of the Federal farm-loan system to finance the purchase of farms, it may not be out of place to consider, in the light of the facts brought out in this study, some of the broad lines that might be followed in providing additional credit facilities. In so doing the authors wish to disclaim any desire to formulate a cut-and-dried plan or to insist dogmatically on the suggestions here made. Moreover, only broad lines of policy are

[1] The above statement is based on census reports, using the preliminary figures for 1920.

suggested, and no attempt is made to consider details or to anticipate in discussion objections that might be raised.

Assuming that in many instances it will be necessary for the would-be purchaser to borrow a considerably larger percentage of the value of the property mortgaged than is now possible under the Federal farm-loan system, it is important to inquire whether the entire loan should be made on first-mortgage security or whether the borrower should be allowed to give a first mortgage for approximately the maximum now permitted and to offer a second mortgage for the remainder.

There are several strong reasons for the latter method. In the first place, the number of loans made to facilitate the purchase of land represents but a small proportion of the total loans on first mortgages. If special credit arrangements should be provided to farmers in becoming owners of their farms, it would not be necessary to extend these special advantages to persons borrowing for other purposes. In the second place, there is a well-established market for conservatively placed first mortgages, in which such mortgages can be resold by the lender, either directly or by issuing bonds secured by specific mortgages, and it would probably be difficult to educate investors to accept mortgages representing a much less conservative margin of credit. In the third place, the borrower is likely to desire, and probably should be required, to repay that part of his loan which exceeds the ordinary margin of credit allowed on first-mortgage security in a shorter period than is now allowed for first mortgages under the Federal farm-loan system. While this is not impossible when the entire loan is secured by a single lien, it is easier to require it, as distinguished from permitting it, when the excess represents a separate contract. In the fourth place, if the Federal farm-loan system were modified to permit a larger credit in some instances, even though such loans represented but a small proportion of the total volume of loans, it is probable that the knowledge of this fact would impair the general market for the bonds based on mortgages as security, and this would probably be the case even though all mortgages exceeding a conservative margin of credit were excluded as a basis for bond issues. Finally, if the system of farm credit should be modified to permit borrowing on a larger proportion of the value of security offered, as a means to home ownership, it would be desirable to provide special restrictions and regulations covering such cases which would not necessarily apply in the case of the larger volume of loans on first-mortgage security.

In providing a special system of second-mortgage credit in the interest of promoting farm home ownership it would probably be

desirable to restrict the benefits of such a system to those whom the act was designed to serve. Not only should it be restricted to the single purpose of buying farm land, but it should also be requisite that the borrower establish the fact that he seeks the aid of the system as a means of becoming an operating farm owner and for a reasonably long time. It might also be possible to devise a method of indirectly limiting the benefits of the system to men of small capital. The system should not facilitate the acquisition of additional farms or even of additional land except when the latter represents a *bona fide* attempt to enlarge or round out a holding previously inadequate for economical operation. Proper administrative safeguards should be provided to insure that the cost of the farm is reasonable enough to justify the presumption of the buyer's paying out on the investment and also that the buyer has sufficient experience and personal ability to justify his undertaking a farm enterprise. Provision should be made to prevent the use of the system for speculation. It seems probable that, thus restricted, the suggested provisions would serve the purpose of promoting farm home ownership on the part of those who would be prevented from attaining that status under present conditions of land values and mortgage credit, and without involving a heavy drain on the Nation's farm-credit machinery.

Such a system might be developed on thoroughly businesslike principles without committing the Nation to anything approaching a class subsidy. It would probably be possible to make such a system pay its way without subjecting the Government to unreasonable risks. Prevailing systems of first-mortgage loans, including the Federal farm-loan system, are based on the theory that each individual mortgage must be absolutely safe, so that in case of foreclosure there will be no reasonable doubt that the value of the farm will repay the debt. This policy is largely due to the practice of reselling individual mortgages or blocks of mortgages or of assigning them as security for bond issues. In fact, it is usually the intent to avoid even the possibility of foreclosure, for most agencies lending on farm mortgages do not care to incur serious risk of having to take over the ownership of the land.

The conservative character of the Federal farm-loan system is due to the fact that it is based on this principle; a fact that renders it useful as a general basis of long-time farm credit, but limits its usefulness as an agency to promote farm ownership among those seeking to establish themselves in the land with limited capital.

It would seem, however, that a system of second mortgages under Government auspices might be developed on the insurance prin-

ciple. Instead of seeking to avoid all risk, such a system would carefully estimate the risks incurred and spread this risk over a large number of loans widely distributed in different sections of the country, charging enough extra on the interest rate to earn the actuarial value of the risk assignable to the particular loan. Such charges could be graded for different degrees of risk. The larger the credit desired the higher the per cent of charge to be added to the basic interest rate. The charge might also be varied according to the section of the country, being made higher, for instance, in regions where frequent drouths occur.

It is obvious that such a basis for credit could not be safely adopted by any agency with only a small volume of loans nor by one whose loans were confined to a single section of the country. For the last-mentioned reason it could not well become a basis for a local system of credit, but might be feasible for an agency doing a large business on a nation-wide scale.

If such a system were developed to supplement the Federal farm-loan system it would be necessary to offer its privileges only to those cases in which the first mortgage is held under the Federal farm-loan system, for the element of risk on the second mortgage would be greatly reduced if both first and second mortgages were controlled by the same agency. Holders of second mortgages have always been faced by the danger of arbitrary foreclosure of the first mortgage, with the resulting destruction of the second-mortgage equity. Many first-mortgage loans are made with the expectation of renewal. If, however, the holder refuses to renew, he may foreclose and force a sale of the property. This may occur even though the farm business is to all intents and purposes solvent. If the same person or agency holds both mortgages he can exercise discretion in protecting the second-mortgage equity.

It is also possible that second mortgages can be made a more effective method of promoting home ownership by providing convenient terms of repayment. While it would probably be the part of wisdom, as suggested above, that the borrower be required to pay off the second mortgage in a shorter period than the maximum allowed for first mortgages under the Federal Farm Loan Act, yet it should be possible to spread the payments over a considerable period. Such payments could be made periodic and on the amortization plan, with privilege of repaying larger amounts on due notice. Mortgages are sometimes given in connection with the purchase of farms on which considerable development work must be done before they can be put on a paying basis. While the work of development is progressing, a mortgage holder could render the farm owner great assistance by deferring all payments, as far as possible, until a paying basis

is reached. In the meantime the value of the security would be increasing as a result of the improvements made. That there is a need for such elements of convenience in second mortgage loans is shown by the number of cases of private loans studied in which provisions of this character occur.

PUBLICATIONS OF THE UNITED STATES DEPARTMENT OF AGRICULTURE RELATING TO FARM CREDIT.

How the Federal Farm Loan Act Benefits the Farmer. (Farmers' Bulletin 792.)
How to Use Farm Credits. (Farmers' Bulletin 593.)
Costs and Sources of Farm Mortgage Loans in the United States. (Department Bulletin 384.)
Factors Affecting Interest Rates and Other Charges on Short-time Farm Loans. (Department Bulletin 409.)
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The Federal Farm Loan Act. (Circular No. 4.)
The Farm Loan Primer. (Circular No. 5.)
Killing Off Mortgages. (Circular No. 7.)
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